November 6, 1986

OCTOBER 1986 MONTHLY REPORT

Surveys of Consumer Attitudes

Richard T. Curtin, *Director*

CONSUMER CONFIDENCE MAINTAINED

- In the October 1986 survey, the Index of Consumer Sentiment was 95.6, up from 91.9 one month earlier, and 88.4 one year earlier. This improvement, however, is minor, as the October 1985 figure was the lowest monthly reading during the past three years. Overall, the October 1986 Index figure is just about equal to the average recorded during the past three years (95.1). The recent improvement was due to more favorable prospects for business conditions.

- Among families with incomes of $30,000 or more, the Index rose to 102.3 in October 1986, from 99.5 one month earlier and 99.6 one year earlier.

- Just under half of all families in the October 1986 survey thought that the economy had improved during the past year (47 percent), and less than a quarter expected the economy to improve during the year ahead. Importantly, rather than expecting an emerging recession, the majority of consumers thought that during the year ahead the performance of the economy would remain essentially unchanged (59 percent). These prospects for an extended expansion, even if slow, have meant to consumers the continuation of good times financially in the economy as a whole, expected by 55 percent in October, up from 50 percent one month earlier.

- Attitudes toward buying conditions for vehicles, homes, and large household durables remained at very favorable levels in the October 1986 survey, although they have receded from the all-time peaks recorded earlier in 1986. The small declines in favorable buying attitudes have been due to less frequent references to interest rate discounts. The proportion holding favorable vehicle buying attitudes fell to 72 percent in October from the all-time peak of 81 percent one month earlier. Favorable home buying attitudes were held by 81 percent in October, down from a peak of 86 percent in April.

- The financial situation of American families remained favorable in the most recent survey. An improved financial situation was reported by 44 percent of all families in October. Thirty-seven percent of all families expected improvement in their financial situation during the year ahead, while 51 percent expected their situation to be neither better nor worse than at present. Very few consumers expected financial reversals during the year ahead (10 percent).

- The federal income tax reforms have only had a marginal impact on consumer attitudes and expectations. The majority of consumers in the October 1986 survey thought that the tax reforms would on balance leave their financial situation unchanged (61 percent). Financial gains were expected by 15 percent of all families, while losses due to the tax reforms were expected by 21 percent. Consumers more often expected the tax reforms to have an impact on business conditions than on their own personal finances, although the most common expectation was still that these reforms would have little net impact.

Monitoring Economic Change Program
Institute for Social Research • P.O. Box 1248 • Ann Arbor, Michigan 48106-1248 • (313) 763-5224

Buying Conditions

Vehicles. Favorable car buying attitudes declined somewhat in the October 1986 survey from the all-time peak recorded one month earlier, falling to 72 from 81 percent. The major reason for this decline has been the withdrawal of interest rate reductions. In the October 1986 survey, 55 percent of all families mentioned the current availability of reduced interest rates, down from the all-time record of 70 percent recorded in September (see Table A). Proportionately, this was a somewhat larger fall off than recorded from September to October of 1985, when mentions of reduced interest rates fell to 40 from 45 percent.

The appeal of interest rate discounts has been amply demonstrated in recent months. Sales of new cars and light trucks in the third quarter of 1986 reached a seasonally adjusted annual rate of 18.5 million units, the highest quarterly sales rate on record (see Table B). This selling rate was significantly higher than the prior peak of 17.0 million units recorded in the third quarter of 1985, which was also prompted by interest rate discounts. But like last year, when the discount programs end, sales can be expected to decline sharply. At annual rates, vehicle sales declined by 2 million units from the third to the fourth quarter of 1985. This decline in sales was countered by the introduction of new incentive programs by year end 1985. And the renewal of incentive programs can again be expected during the year ahead.

Each new round of incentive programs has been based on progressively lower interest rates—falling from over 12% to under 3% over the length of the current economic expansion. This progression toward lower interest rates has now been largely exhausted; although longer maturity loans at these lower interest rates could further stimulate sales. Even though these incentive programs have proved to be an expensive means to promote sales, consumer reactions are likely to insure their continued availability. Consumers have now come to expect sellers to offer discounts, and to time their purchases to their availability. The withdrawal of discount programs is now met with sharp declines in sales,

both because consumers have sped up purchases to take advantage of discounts, and because consumers are more willing to postpone purchases as they expect renewed discounting in the future.

Homes. Favorable home buying attitudes were held by 81 percent of all families in the October 1986 survey, down from 83 percent one month earlier, and the all-time peak of 86 percent first recorded six months earlier. The small recent decline has been due to a somewhat less favorable view of mortgage interest rates. In the October 1986 survey, 69 percent mentioned the availability of reduced mortgage interest rates, down from 74 percent one month earlier, and 78 percent six months earlier.

These very favorable home buying attitudes have been reflected in sales. Single family homes were purchased at an annual rate of 4.3 million units in the third quarter of 1986, up from 4.1 million units in the comparable period one year earlier (see Table B). Most of the improvement during the past year has been in purchases of existing homes, rather than those newly built. Although the current sales rate is well below the peak year of 1978—when 4.8 million homes were purchased—it represents the best performance thus far in the 1980's.

Durables. Buying conditions for large household durables were viewed favorably by 76 percent of all families in the October 1986 survey, unchanged from one month earlier, and somewhat below the all-time record of 81 percent recorded four months earlier. References to price and interest rate discounts continue to dominate these very favorable views. In the October 1986 survey, in total 59 percent mentioned either price or interest rate discounts, compared with just 9 percent that complained about high prices or interest rates.

Total consumption spending has risen significantly since the start of 1986. In the third quarter, total consumption spending increased by 7.2%, twice the quarterly growth rate recorded at the start of the year. Thus far in 1986, growth in spending has averaged 5.7%, substantially above the 1985 increase of 3.5% (see Table B). Because income has

not grown as fast as consumption, the rate of savings has fallen significantly. Thus far in 1986, the quarterly growth rate in personal disposable income has averaged 3.8%, compared with a 5.7% average growth rate in spending. As a result, the savings rate in the third quarter of 1986 reached the record low level of 2.9% (Table 1).

Business Conditions

Consumers reported only half as many favorable developments in the economy in the October 1986 survey compared with six months earlier—falling to 26 from 55 percent. Most of the fall involved fewer reports of declines in prices and interest rates. Six months ago, in the April 1986 survey, 61 percent of all families thought that the economy had improved during the prior year, which fell to 47 percent in August and has remained unchanged at that level through the October 1986 survey.

Most families expected the performance of the national economy to remain unchanged during the year ahead (59 percent). Fewer consumers expected either improvement (21 percent) or deterioration (18 percent) during the year ahead. Just over half of all families in the October 1986 survey thought that the national unemployment rate would remain largely unchanged during the year ahead at about its current level (55 percent). Only 10 percent of all families in the October survey expected declines in the unemployment rate during the year ahead, the lowest level recorded in more than three years. In comparison, 33 percent of families in the October survey expected an increasing unemployment rate during the year ahead.

Although only 21 percent expected the economy to improve, more than twice that many expected good times financially in the country as a whole. In the October 1986 survey, 55 percent expected good economic times during the next twelve months, up from 50 percent one month earlier and 49 percent one year earlier. Consumers thought that prospects over the longer term had also improved, as 41 percent expected good times during the next five years in October, up from 33 percent in September.

Personal Finances

An improved financial situation was reported by 44 percent of all families in the October 1986 survey, down from the cyclical peak of 49 percent recorded three months earlier, but still above the 39 percent recorded one year earlier. During the past three months, mentions of income increases have fallen (39 to 32 percent), but remained just above the year earlier level (31 percent). Complaints about eroding living standards due to inflation fell to just 9 percent in October, unchanged from three months earlier, and the lowest level since the mid 1960s. From the start of 1986 to the end of June, the net change in the CPI was nearly zero, and through the first nine months of 1986, price increases have remained under 1%. This virtual absence of inflation has had an important impact on the personal financial situation of families.

In the October 1986 survey, 37 percent of all families expected their personal financial situation to improve during the year ahead, up from 33 percent in October 1985. This small improvement was reflected in the proportion of families that expected income increases, rising from 56 to 61 percent during the past year. Half of all families, however, expected their financial situation to remain unchanged during the year ahead (51 percent). Few families expected their financial situation to worsen during the year ahead—just 10 percent in the October 1986 survey, unchanged from one year earlier.

Tax Reform

In the October 1986 survey, consumers were asked about the impact they expected the federal income tax reforms to have on their own personal financial situation and on business conditions in general. When asked about the impact on their own finances, 61 percent of all families thought that the federal tax reforms would leave their financial situation largely unchanged. Among the balance of families, however, a slightly larger proportion expected to be worse off rather than better off financially—21 versus 15 percent (see Table C). Opinions concerning the impact of tax reform on overall business conditions, in comparison, were more diverse; fewer consumers expected the tax reforms to leave

overall business conditions unchanged (43 percent), and more families expected either favorable or unfavorable effects. But like personal finances, the balance of opinion tilted toward unfavorable expectations, by the margin of 28 versus 18 percent.

Interestingly, very few consumers thought that the tax reform would have a favorable impact on both personal and business conditions (5 percent); twice as many expected an unfavorable impact in both areas (12 percent). Overall, 33 percent of all consumers thought that the tax reform would leave both their own finances and overall business conditions unchanged.

Consumers were also asked what impact the tax reforms would have on their current spending plans. Among all families, 10 percent reported that they both itemized their tax deductions and would speed up their purchases to take advantage of deductions that would be lost. Most of the purchases that would be accelerated were vehicles--reported by 6 percent of all families. An additional 2 percent reported plans to move up purchases of major household durables.

While it is true that families that expected the tax reform to improve economic conditions also gave more favorable responses across a wide array of attitudes and expectations, more families expected unfavorable impacts, and their attitudes and expectations were correspondingly lower than average. Overall, the tax reform has only had a limited impact on consumers, since the most common assessment has been that these reforms would not make much difference on balance.

Summary Outlook

Price and interest rate reductions have been responsible for the current extended period of consumer confidence. The response of consumers to the recent interest rate discounts on new vehicle purchases not only attests to their continued willingness to make major purchases, but also to their willingness to commit future income to the repayment of debt. This sense of confidence, however, is limited to the maintenance of the status quo, rather than the expectation of better times to come. Few consumers expect the economic

situation to improve during the year ahead, either for themselves or for the country as a whole. Neither do they expect the economic situation to worsen. Most consumers expect an unchanged overall economic situation during the year ahead. And given the length of the current expansion, most consumers have judged this to mean the continuation of good times financially.

Given these prospects, and the record debt levels needed to finance the surge in third quarter sales, consumers will be more cautious in their spending plans, but without an overall retrenchment. With debt burdened family budgets, judgements about the affordability of purchases will increasingly focus attention on the availability and size of discounts on prices and interest rates. And consumers willingness to time their purchases according to the available discounts will continue to shape aggregate trends. Consumers now expect both the repeated use of discounts by sellers to stimulate sluggish sales, and an economic environment where such slowdowns in sales can be expected.

• • •

The October 1986 survey included 651 completed interviews, conducted between October 1 and October 30, 1986.

TABLE A

REFERENCES TO INTEREST RATES IN SUPPORT OF FAVORABLE BUYING CONDITIONS

Survey Date		Durables		Houses[a]		Vehicles	
		Low Rates	BIA[b] Rates	Low Rates	BIA Rates	Low Rates	BIA Rates
January	1984	8%	1%	33%	8%	20%	3%
February	1984	9	2	38	12	19	3
March	1984	8	2	36	13	19	3
April	1984	8	6	29	23	15	7
May	1984	7	4	24	20	14	4
June	1984	7	4	21	17	12	6
July	1984	5	5	21	16	16	8
August	1984	6	2	22	13	12	5
September	1984	6	2	22	12	11	4
October	1984	7	4	24	11	10	4
November	1984	8	3	33	11	15	3
December	1984	8	2	32	6	12	3
January	1985	10	1	42	7	21	2
February	1985	9	2	42	8	23	1
March	1985	8	2	38	10	21	2
April	1985	10	3	34	13	22	3
May	1985	9	2	35	8	25	3
June	1985	11	2	50	6	32	3
July	1985	13	1	51	6	33	2
August	1985	15	*	54	4	35	1
September	1985	14	1	51	5	45	1
October	1985	14	1	48	7	40	1
November	1985	10	2	45	7	38	2
December	1985	11	1	47	6	35	2
January	1986	17	1	55	5	50	1
February	1986	18	2	60	4	51	2
March	1986	21	1	73	4	52	2
April	1986	27	2	78	5	52	2
May	1986	30	1	76	4	57	1
June	1986	30	1	78	5	59	3
July	1986	25	1	70	7	52	1
August	1986	25	1	73	5	51	1
September	1986	29	*	74	5	70	3
October	1986	24	2	69	6	55	3

*Less than 0.5 percent. [a]Also includes homes, home repairs and real estate.

[b]The proportions given above provide greater detail than is reported in the monthly tables (see Tables 22, 24 and 26). The figures above divide the total proportion of respondents that made favorable references to credit conditions into those respondents that referred to the current availability of *low interest rates*, and those that referred to *borrowing-in-advance* (BIA) of rising interest rates.

TABLE B

TRENDS IN PERSONAL CONSUMPTION, INCOME, AND SAVING

	Vehicles[a]			Homes[a]			Change in[b]		
Year	Cars	Trucks	Total	New	Existing	Total	Consumption	Disposable Income	Savings Rate
1971	10.2	1.8	12.0	0.7	2.0	2.7	3.1%	3.6%	8.5%
1972	10.9	2.2	13.1	0.7	2.3	3.0	5.4	4.0	7.3
1973	11.4	2.7	14.1	0.6	2.4	3.0	4.2	6.6	9.4
1974	8.8	2.3	11.1	0.5	2.3	2.8	−0.9	−1.0	9.3
1975	8.5	2.2	10.7	0.5	2.5	3.0	2.3	1.9	9.2
1976	10.0	2.9	12.9	0.7	3.0	3.7	5.4	3.6	7.7
1977	11.1	3.3	14.4	0.8	3.7	4.5	4.4	3.3	6.6
1978	11.2	3.7	14.9	0.8	4.0	4.8	4.1	4.9	7.1
1979	10.6	3.1	13.7	0.7	3.8	4.5	2.2	2.1	6.8
1980	9.0	2.2	11.2	0.5	3.0	3.5	−0.2	0.1	7.1
1981	8.5	2.1	10.6	0.5	2.4	2.9	1.2	1.6	7.5
1982	8.0	2.4	10.4	0.4	2.0	2.4	1.3	0.6	6.8
1983	9.2	2.9	12.1	0.6	2.7	3.3	4.7	3.1	5.4
1984	10.4	3.8	14.2	0.6	2.9	3.5	4.7	6.0	6.3
1985	11.0	4.4	15.4	0.7	3.2	3.9	3.5	2.3	5.1
1986:1	10.7	4.1	14.8	0.8	3.3	4.1	3.6	6.5	5.0
1986:2	11.2	4.6	15.8	0.8	3.5	4.3	6.2	7.1	5.0
1986:3	13.2	5.3	18.5	0.7	3.6	4.3	7.2	−2.2	2.9

[a]Millions of units sold. Quarterly figures at annual rates.

[b]Percentage changes, 1982 dollars.

TABLE C

EXPECTED IMPACT OF FEDERAL TAX REFORM ON PERSONAL FINANCES AND BUSINESS CONDITIONS

	Business Conditions	Personal Finances
Better	18%	15%
Same	43	61
Worse	28	21
DK	10	3
NA	1	*
Total	100%	100%
Cases	651	651

The questions were: "The federal income tax reform law will reduce deductions and lower tax rates for most people. During the next year or so, do you think that business conditions in the country as a whole will be better or worse with these changes in the tax laws, or won't these changes make much difference to business conditions?" and "During the next year or so, do you think that you (and your family living there) will be better or worse off financially with these changes in the federal tax laws, or won't these changes make much difference to your financial situation?"